

STATE OF COLORADO

GENERAL SUPPORT SERVICES OFFICE OF THE STATE CONTROLLER

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Roy Romer
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Clifford W. Hall
State Controller

October 30, 1998

To the Citizens, Governor, and Legislators of the State of Colorado

It is our privilege to present the Comprehensive Annual Financial Report (CAFR) on the operations of the State of Colorado for the fiscal year ended June 30, 1998. This report is prepared by the Office of the State Controller and is submitted pursuant to Colorado Revised Statutes 24-30-204. The state controller is responsible for managing the finances and financial affairs of the state and is committed to sound financial management and accountability of state government to its citizens.

We believe the financial statements are fairly presented in all material aspects. They are presented in a manner designed to set forth the financial position, results of operations, and changes in fund balances of the various fund types. All required disclosures have been included to assist the members of the General Assembly, the financial community, and the public to understand the state's financial affairs.

The financial statements contained in the CAFR are prepared in conformity with generally accepted accounting principles applicable to government as prescribed by the Governmental Accounting Standards Board (GASB), and are audited by the state auditor of Colorado. In addition to the general purpose financial statements, the CAFR includes: combining financial statements, presenting information by fund; supporting schedules; certain narrative information describing individual funds; and statistical tables presenting financial, economic, and demographic data about the state.

The funds and entities included in the CAFR are those for which the state is financially accountable based on criteria for defining the financial reporting entity prescribed by GASB. The primary government is the legal entity that comprises the funds and account groups of the state, its departments, agencies, and state funded institutions of higher education. It also includes certain university foundations that have been included with the institution that is financially accountable for the foundation.

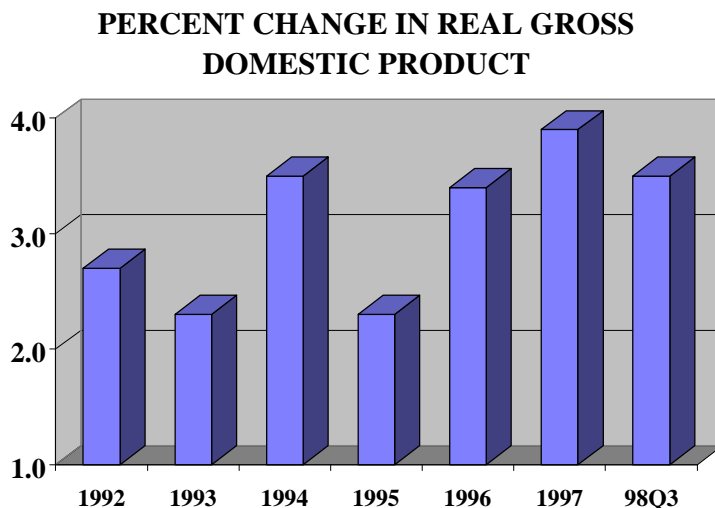
Discretely presented in the financial statements are component units, which are legally separate entities, for which the state's elected officials are financially accountable. These component units are the following entities:

- Colorado Uninsurable Health Insurance Plan
- Colorado Water Resources and Power Development Authority
- Denver Metropolitan Major League Baseball Stadium District
- University of Colorado Hospital Authority
- Colorado Travel and Tourism Authority

Additional information about these component units and other related entities is presented in this report in Note I-A of the footnotes to the general purpose financial statements. Audited financial reports are available from each of these entities.

ECONOMIC CONDITION AND OUTLOOK

The U.S. Commerce Department reported that real Gross Domestic Product (GDP), the output of goods and services produced in the United States, increased at an annual rate of 3.3 percent in the third quarter of 1998. This followed a first quarter increase in real GDP at an annual rate of 5.5



percent, and a second quarter annual rate of a modest 1.8 percent. Both the second and third quarters' growth were influenced by the General Motors strike. GDP figures adjusted for inventory changes were 4.6 percent and 2.3 percent for the second and third quarter, respectively.

Overall, businesses turned cautious in the third quarter though investments in new computers remained strong. Overall, spending on new equipment increased at a low 1.1 percent annual rate, the smallest

gain in seven years. Spending on new buildings and structures fell at a 6.5 percent annual rate, the third straight quarterly drop.

An increase of inventories added a full percentage point to the third quarter increase in GDP. This was probably unintentional but occurred because final sales dropped to a 2.3 percent annual rate of growth from the second quarter's 4.6 percent pace. The National Association of Purchasing Management reported that its monthly index of business activity fell to 48.3 in October, from 49.4 percent in September 1998. A reading under 50 percent is a sign of contraction in the industrial sector. Inflation remains low. The GDP's implicit price deflator rose at a 0.8 percent annual rate in the third quarter. That is the lowest rate since the mid-1960s.

According to the U.S. Commerce Department, the U.S. trade deficit with the rest of the world surged in August to a record high as the global financial crisis depressed exports for the fifth straight month. Exports fell by 0.3 percent in August while imports rose by 2.2 percent. U.S. manufacturing is now operating at just a little over 80 percent of capacity, the lowest in five years.

The U.S. Department of Labor reported that wages and salaries paid to U.S. workers rose by 3.7 percent in the twelve months ending September 30, 1998. Strong wage growth in the last year was the result of a very low unemployment rate. Last April and May the unemployment rate had sunk to a 28 year low of 4.3 percent, and has risen only slightly since then to 4.6 percent in September.

The U.S. economy continues its unprecedented expansion because of the willingness of consumers to continue spending. Personal income rose a modest 0.2 percent in September. The smallest

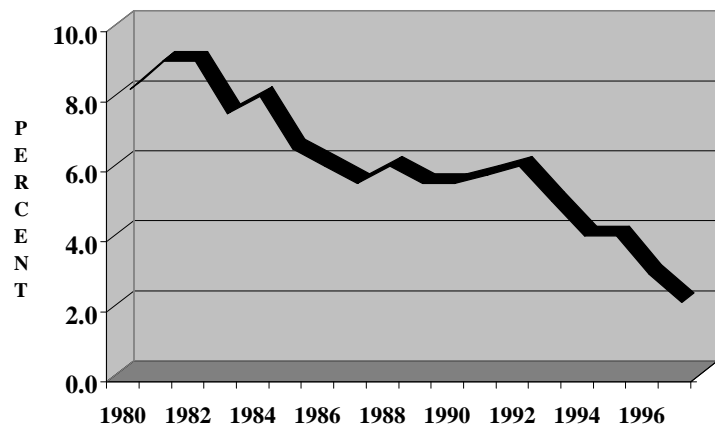
increase since November 1994. Spending, however, increased a strong 0.5 percent resulting in the worst showing for savings since the U.S. Commerce Department started tracking the savings rate on a monthly basis in 1959. The savings rate, savings as a percentage of after tax income, was a minus 0.2 percent in September. So far in 1998 the savings rate has been running at 0.6 percent, down from 2.1 percent in 1997 and 2.9 percent in 1996. Over the past four years, households have been raising their spending faster than their disposable income. Rising housing prices and rising stock investments have added tremendous wealth to household balance sheets. This, along with low unemployment rates, has resulted in all time high rates of consumer confidence, and high confidence in the future suppresses the inclination to save.

Unemployment in Colorado rose to 3.5 percent in September 1998, from a 21-year record low of 2.8 percent in January 1998. Employment though, reached a record 2.2 million jobholders even though the manufacturing sector lost 1,300 jobs in September. Colorado manufacturing is feeling the effects of the Asian crisis and employment in that sector has barely registered a gain for the year.

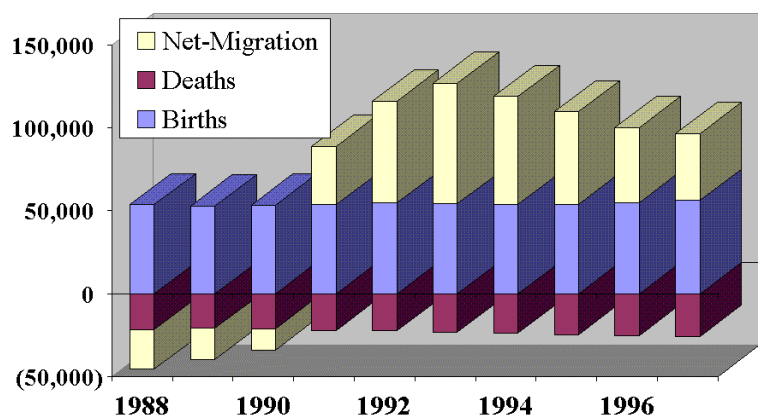
The Colorado residential housing market is experiencing continued strong growth. Housing starts have seen their value increase by 15 percent from last year and should be up for the rest of 1998. In-migration remains strong, along with job growth, as the main drivers of Colorado's economic expansion. Migration should remain strong in 1998 with a forecast of 38,000 increase in net migration. Colorado's population growth in 1998 should be approximately 1.8 percent, almost double the U.S. population growth rate of 1.0 percent.

Any national recession should be milder on Colorado than the nation as a whole. The state has far less exposure in industries with substantial excess capacity such as autos, aircraft manufacturing, chemicals, semiconductors, paper products, and textiles. Colorado has diversified substantially from its historical reliance on the extractive industries and now has a substantial manufacturing presence in high-tech manufacturing, telecommunications, and a growing software industry.

PERSONAL SAVINGS AS A PERCENT OF DISPOSABLE PERSONAL INCOME



COMPONENTS OF COLORADO'S POPULATION CHANGE



If one industry in the state has been hurt by the Asian crisis it is agriculture. The majority of agricultural sales and income is from cattle, wheat, and corn. Producers of these commodities are dependent upon export markets. The U.S. Department of Agriculture projects a 5.0 percent decline in Colorado farm income for 1998.

Slower economic activity is seen for the state in 1999. Export markets will be weak because of the Asian crisis, the costs of living and doing business in Colorado have increased, business is finding it difficult to attract qualified workers, and a slowdown is anticipated for the construction industry, especially in the non-residential sector.

YEAR 2000 COMPLIANCE

The state currently has initiatives underway to address the potential impact the Year 2000 Problem will have on the information technology of the state. This problem is the result of many of the state's existing information technology applications having a two-digit indicator but not a century indicator. The state is actively addressing the Year 2000 Problem. If the current progress continues the Year 2000 project should be completed as planned. However, the Year 2000 project is very large and unexpected difficulties could be encountered. Further, the state has no control over the Year 2000 remediation efforts of major service providers of the state. It is possible, therefore, that even if the state were fully Year 2000 compliant service providers of the state could adversely affect the state's business. Thus, the state is unable to provide any assurances, guarantees or warranties regarding Year 2000 matters. Progress information can be viewed on the state's web site at www.state.co.us/Y2K.

MAJOR GOVERNMENT INITIATIVES

Between 1987 and 1997 the vehicle miles traveled on state highways rose 37.3 percent while the state's population increased 19.3 percent in the same period. Due to demand for improved transportation and relief from traffic congestion, for a ten year period beginning July 1, 1997, the state will allocate 10 percent of the General Fund sales tax to the Highway Users Tax Fund (HUTF). During Fiscal Year 1997-98, \$154.6 million was allocated to the HUTF.

The state completed implementing the Electronic Benefits Transfer System for social assistance benefits as mandated by the federal government.

The General Assembly submitted a referendum for the November 4, 1998 general election for continuation of a 0.1 percent sales tax in the Denver metropolitan area to build a new football stadium. The same tax was used to build Coors Stadium, the current home of the Colorado Rockies Baseball Team.

The General Assembly also submitted a referendum for the November 4, 1998 general election that if approved would allow the state to retain \$200 million of the TABOR revenue surplus for each of the next five years.

BUDGETARY CONTROLS AND ACCOUNTING SYSTEMS

The annual budget of the state for ongoing programs, except for federal and custodial funds, is enacted by the General Assembly. New programs are funded for the first time in the enabling legislation and continued through the Long Appropriations Act in future periods. For the most part, appropriations lapse at the end of the fiscal year unless the state controller approves an appropriation roll-forward required by extenuating circumstances. Capital construction appropriations are normally effective for three years.

The budget is recorded in the state's accounting system along with federal awards and custodial funds of the various departments. Encumbrances are also recorded and result in a reduction of the budget authority. Encumbrances represent the estimated amount of expenditures that will be incurred when outstanding purchase orders are filled or contracts or other commitments are fulfilled. Open encumbrances in the General Fund are not reported as a reservation of fund balance unless the related appropriations are approved for roll-forward to the subsequent fiscal year. Fund balance is reserved for open encumbrances that represent legal or contractual obligations in the Capital Projects Fund and the Department of Transportation's portion of the Special Revenue Fund.

The state's financial records for governmental type funds are accounted for on a modified accrual basis with the revenues recorded when available and measurable, while expenditures are recorded when goods or services are received or a liability is expected to be liquidated from current available resources. Accounting records for proprietary and fiduciary type funds are maintained on the full accrual basis. That is, revenues are recorded when earned, and expenses, including depreciation, are recorded when incurred.

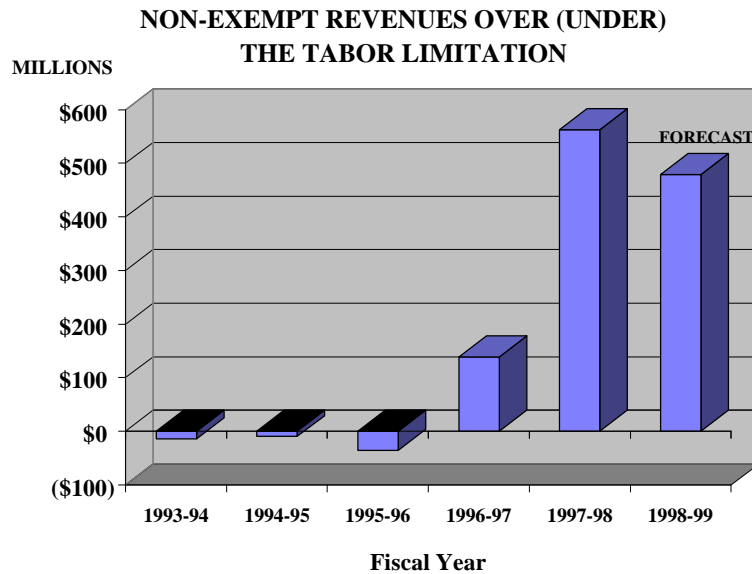
In developing the state's accounting system, consideration has been given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition. Those controls also assure the reliability of financial records for preparing financial statements and maintaining the accountability for assets.

The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from that control. The evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within this framework. We believe that the state's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

FINANCIAL OVERVIEW

Fiscal year 1997-98 is the fifth year of state operations under the TABOR revenue limitations (Article X, Section 20 of the state's constitution). With certain exceptions, the rate of growth of state revenues is limited to the combination of the percentage change in the state's population and inflation based on the Denver-Boulder CPI-Urban index. The exceptions include federal funds, gifts and donations, sales of property, refunds, damage recoveries, and transfers.

Revenues collected in excess of the limitation must be returned to the citizens unless a vote at the annual election in November allows the state to retain the surplus. TABOR also limits the General Assembly's ability to raise taxes. With the exception of a declared emergency, taxes can only be raised by a vote of the people at the annual election.



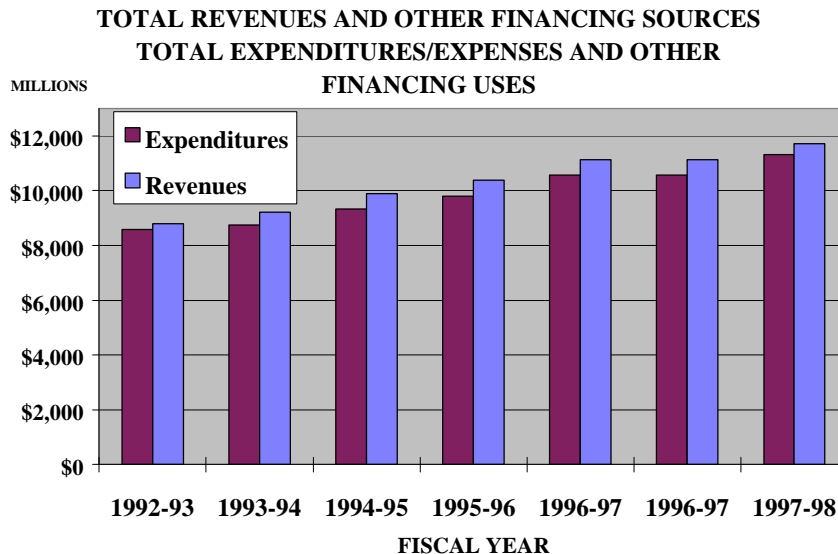
In the first three years of operation the state had not exceeded the limitation for revenues. In Fiscal Year 1997-98 and 1996-97, state revenues exceeded the TABOR limitation by \$563.2 million and \$139.0 million, respectively. The state recorded a liability in the General Fund at June 30, 1998 and 1997, for these amounts. See Note VI-D Sales Tax Refund, in the notes to the financial statements for additional details.

As the above chart indicates, the Office of State Planning and

Budgeting forecasts larger revenues than the TABOR amendment allows unless there is a reduction in taxes and/or fees collected by the state. It should be noted that the Fiscal Year 1998-99 TABOR Revenue Limitation is 2.7 percent below the pre-refund actual revenues for Fiscal Year 1997-98.

The current combined balance sheet for the state's primary government shows total assets of \$12,356 million and liabilities of \$3,744 million. Under current accounting principles this difference of \$8,612

million is the financial equity that the citizens of Colorado have in their state government. The state's current accounting practices do not include the recording of infrastructure on the state's books. Thus, the recorded equity is exclusive of such assets as highways, bridges, and parks. Similarly, there is no recording of the estimated cost to maintain those assets.



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Total revenues and other financing sources for the primary government, excluding operating transfers-in and

excess TABOR revenues, were \$11,713 million and \$11,134 million in Fiscal Years 1997-98 and 1996-97, respectively. Total expenditures/expenses and financing uses, excluding operating transfers-out and

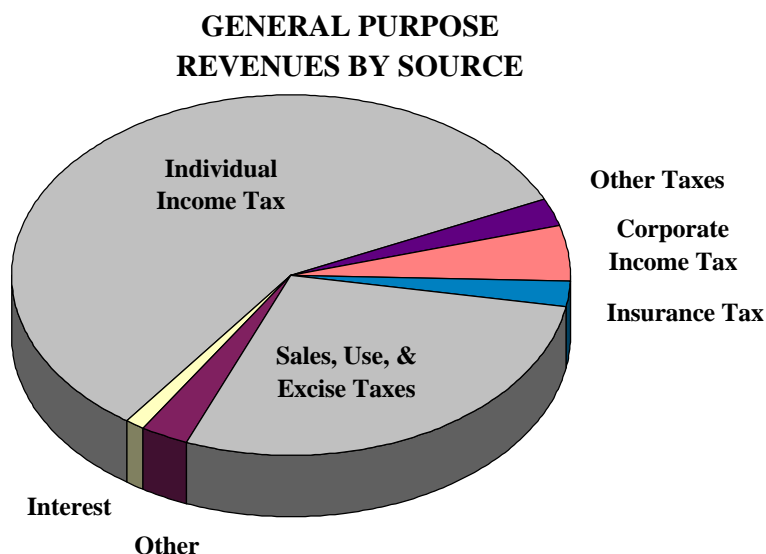
the TABOR refund liability in Fiscal Year 1996-97, were \$11,312 million and \$10,587 million for each of the same periods.

Various fund equity accounts, were larger at the end of the year than at the beginning, primarily because revenues, other financing sources, and transfers-in exceeded expenditures, other financing uses, and transfers-out for Fiscal Year 1997-98. The equities of the governmental fund types rose \$38.5 million, the combined fund equities of the colleges and universities increased by \$282.2 million, and the Trust Funds had an increase of \$121.8 million, excluding the Investment Trust Fund created by the implementation of a new accounting pronouncement.

GENERAL FUND ACTIVITIES

The General Fund is the focal point in determining the state's financial position. This fund accounts for all revenues and expenditures that are not required by law to be accounted for in other funds. Revenues of the General Fund consist of two broad categories, general purpose revenues and augmenting revenues. General purpose revenues are taxes, fines, and other similar sources that are raised without regard to how they will be spent. Augmenting revenues consist of federal funds, transfers-in, cash fees and charges, or specific user taxes. Augmenting revenues are usually restricted as to how they can be spent.

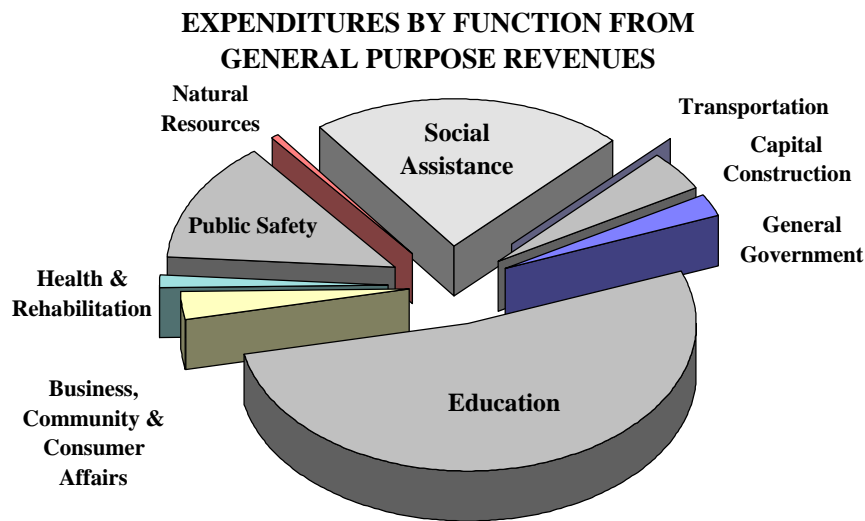
In the CAFR, all statements depicting the General Fund in the General Purpose Financial Statements Section include general purpose and augmenting revenues. The *Schedule of Revenues, Expenditures, and Changes in General Fund Surplus, Budget and Actual*, presented in the Combining Financial Statements and Schedules Section, includes only the general purpose revenues and expenditures supported by those revenues.



Beginning in Fiscal Year 1997-98, the state began allocating 10 percent of the General Fund sales and use tax revenues to the Highway Users Tax Fund (HUTF). These revenues, which amounted to \$154.6 million in Fiscal Year 1997-98, are no longer recorded as general purpose revenues.

General purpose revenues for Fiscal Years 1997-98 and 1996-97 were \$5,244 million and \$4,679 million, respectively. Sales and use taxes decreased by \$34.2 million or 2.4 percent because of the allocation to HUTF. Individual income taxes increased by \$479.1 million or 18.6 percent. This large increase in income taxes demonstrates the continued health of the Colorado economy and continued robust job and population growth in the state during Fiscal Year 1997-98.

Total expenditures and transfers-out funded from general purpose revenues during Fiscal Years 1997-98 and 1996-97 were \$4,724 million and \$4,534 million, respectively. The Departments of Education, Health Care Policy and Financing, Higher Education, and Human Services accounted for approximately

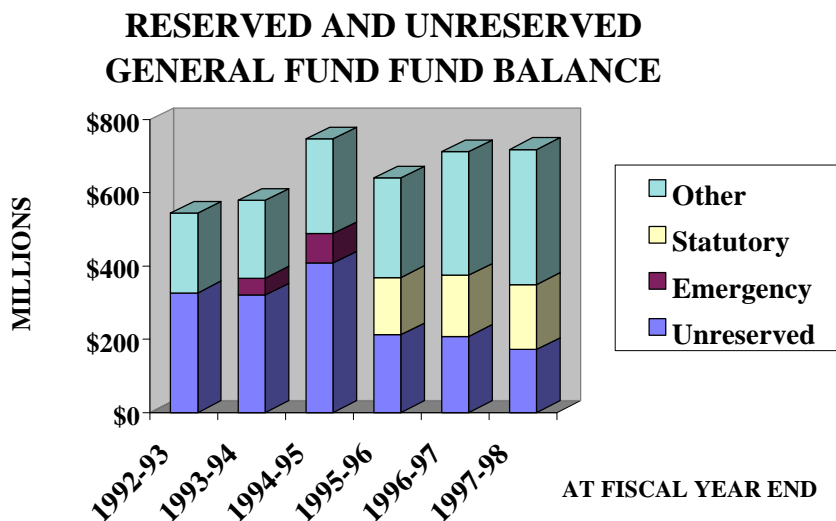


79.5 percent of all Fiscal Year 1997-98 general funded expenditures. Of the departments with substantial general funded expenditures, the Department of Revenue had the largest annual percentage increase at 33.2 percent over the previous year. This is due to the substitution of general purpose revenues for HUTF revenues in funding elements of the department such as the Motor Vehicle Division. For the last several years the Department of Corrections

has been the fastest growing general funded department. Its expenditures financed by general purpose revenues grew by 15.6 percent over Fiscal Year 1996-97.

In addition to TABOR revenue limitations mentioned under the section "Financial Overview", the total annual increases in general funded expenditures are limited to 6 percent over the previous year with certain adjustments. The primary adjustments are for changes in federal mandates and lawsuits against

the state. This limitation is controlled through the legislative budget process.



The "Unreserved" title, in the fund equity section of the General Fund on the *Combined Balance Sheet* of the General Purpose Financial Statements, relates to the accumulated net general purpose revenues. The cumulative net augmenting revenues are represented as "Reserved For Other Specific Purposes." Augmenting revenues of the General Fund were \$2,128

million and \$2,089 million in Fiscal Year 1997-98 and 1996-97, respectively. Federal grants and contracts made up 87.8 percent and 88.4 percent of this amount in each respective fiscal year. The remainder is cash funds, which consist of revenues of specific programs that are statutorily restricted.

During Fiscal Years 1993-94 and 1994-95 a portion of the fund balance was reserved for emergencies as required by Article X, Section 20 (TABOR) of the state constitution. Beginning with Fiscal Year 1995-96, a portion of the fund balance of the Controlled Maintenance Trust Fund is designated by the legislature as the TABOR emergency reserve.

Beginning in Fiscal Year 1995-96, the state controller reserved an amount equal to the statutorily required four percent of General Fund appropriation. Prior to that year the four percent reserve was determined during the appropriation process but was not formally recognized in the financial statements.

PROPRIETARY OPERATIONS

Proprietary type funds are accounted for using the full accrual basis of accounting as would a private business. Their operations have many of the attributes of a business in that their revenue relates to the provision of goods or services to the state or to the general public. Capital investments of these operations are recorded within the fund and depreciation is recorded using methods similar to private enterprise. Proprietary funds consist of enterprise funds that provide services to the citizens of the state, and internal service funds that provide services to the state government.

For Fiscal Year 1997-98, proprietary fund types had an equity increase of \$134,221. The Telecommunications Internal Service Fund received \$114,074 of fixed assets and the State Nursing Homes Enterprise Fund received \$95,541 of fixed assets funded by the Capital Construction Fund. The Highway Fund, a special revenue fund, transferred \$113,813 to the Highways Internal Service Fund.

Total fund equity for the proprietary funds at June 30, 1998 and June 30, 1997, were \$109.4 million and \$109.2 million, respectively. Operating revenues for the proprietary operations were \$685.3 million for Fiscal Year 1997-98 and \$648.6 million for Fiscal Year 1996-97. Operating expenses were \$640.8 million and \$608.6 million, respectively. During Fiscal Year 1997-98, the major transfers from the Lottery Fund were \$35.5 million to the Conservation Trust Fund and \$8.9 million to the Wildlife Fund. In addition, \$53.0 million was distributed from the Lottery Fund's net proceeds to the Great Outdoors Colorado Trust Fund, a constitutionally created public authority.

DEBT ADMINISTRATION

The State of Colorado is prohibited by its constitution from incurring any general obligation debt. Many higher education institutions have issued bonds and notes with revenues pledged from specific user payments to retire these bonds and notes. Additional information is provided in the footnotes to the general purpose financial statements and the statistical section of this report.

CASH MANAGEMENT

Statutes permit the state treasurer to invest cash not needed immediately to pay obligations of the state. These investments may consist of obligations of the United States, commercial paper of prime quality, repurchase agreements, bank acceptance agreements, and other investment instruments. The state treasurer also invests the funds of the Colorado Water Resources and Power Development Authority, a

component unit, and the Great Outdoors Colorado Trust Fund. At June 30, 1998, the state treasurer held the following investments at fair value:

Investment Type	Amount in Millions
United States Treasury and Agencies	\$1,743.7
Asset Backed Securities	869.6
Mortgages	351.3
Commercial Paper	558.2
Bankers' Acceptance	76.9
Corporate Bonds	558.5
TOTAL	<u>\$4,158.2</u>

Included above is \$772.1 million belonging to the Colorado Compensation Insurance Authority that the state treasurer maintains in a separate investment trust fund. The financial statements of that fund are included in this report.

RISK MANAGEMENT

The state self-insures its agencies, officials, and employees for the risks of losses for general liability, motor vehicle liability, workers' compensation, and medical claims. The state uses the General Fund and the General Long-Term Debt Account Group to account for the risk management function including operations and for all claims or judgments except for employee medical claims. (See Notes I-E, IV-D, and IV-F to the General Purpose Financial Statements). Medical claims for officials and employees are managed through the State Employees and Officials Insurance Fund, an internal service fund. Property claims are not self-insured, as the state has purchased insurance. (See Note IV-F to the General Purpose Financial Statements.)

The Regents of the University of Colorado are self-insured for workers' compensation, auto, general and property liability, and official's and employee's medical claims. The university's medical claims are handled by a third party through a contractual agreement. The university has also purchased stop-loss insurance for individual medical claims in excess of \$500,000. (See Note IV-F to the General Purpose Financial Statements.)

INDEPENDENT AUDIT

The audit of the General Purpose Financial Statements was performed by the state auditor. The opinion of the auditor is on page 25 of this report preceding the financial statements. Besides an audit of the statewide financial statements, the auditor will from time to time audit the financial statements and operations of various departments and institutions within state government.

In 1996, the United States Congress amended the Single Audit Act of 1984. The amended act clarifies the state's and the auditor's responsibility for ensuring that the use and accounting for federal moneys is proper. Under the requirements of this act, transactions of major federal

programs are tested. The state prepares a Schedule of Expenditures of Federal Awards for inclusion in the state auditor's Statewide Single Audit Report. The state auditor issues reports on the schedule, the financial statements, internal controls, and compliance with the requirements of federal assistance programs.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the state for the Fiscal Year 1996-97 Comprehensive Annual Financial Report. The Certificate of Achievement is a prestigious national award which recognizes conformance with the highest standards for preparation of state and local government financial reports. This is the first year that the state has received this award.

ACKNOWLEDGMENTS

In conclusion, I thank my staff and the staffs of all the state departments and institutions whose time and dedication have made this report possible. I reaffirm our commitment to maintaining the highest standards of accountability in financial reporting.

Sincerely,

A handwritten signature in black ink that reads "Clifford W. Hall". The signature is written in a cursive, slightly slanted style.

Clifford W. Hall
State Controller